

EX PARTE OR LATE FILED

STATE OF CALIFORNIA — STATE AND CONSUMER SERVICES AGENCY

PETE WILSON, Governor



**LEGAL AFFAIRS**

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April 10, 1997

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Mr. William F. Caton  
Secretary  
Federal Communications Commission  
1919 M Street, N.W., Room 222  
Washington, D.C. 20554

Re: Ex Parte Communication  
CC Docket No. 96-45

Dear Mr. Caton:

On April 9, 1997, the California Department of Consumer Affairs sent a written communication regarding issues relating to the above-captioned proceeding to Federal Communications Commission ("FCC") Chairman Reed E. Hundt, Commissioners Rachelle B. Chong and Susan Ness, each member of the Federal-State Joint Board, and FCC Common Carrier Bureau Chief Regina M. Keeney.

In accordance with the FCC's rules of practice and procedure, enclosed are two copies of a Notice of Ex Parte Communication which includes a copy of that written communication. Please include it in the public record of this proceeding.

Respectfully submitted,

VIRGINIA J. TAYLOR  
Staff Counsel

RICHARD A. ELBRECHT  
Supervising Attorney

Enclosure

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**BEFORE THE  
FEDERAL COMMUNICATIONS COMMISSION  
WASHINGTON, D.C. 20554**

In the Matter of )  
Federal-State Joint Board )  
on Universal Service )  
\_\_\_\_\_ )

CC Docket No. 96-4

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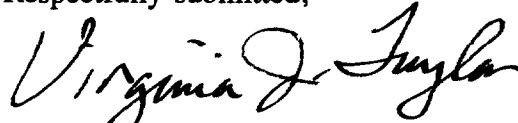
**EX PARTE COMMUNICATION OF THE  
CALIFORNIA DEPARTMENT OF CONSUMER AFFAIRS**

On April 9, 1997, the California Department of Consumer Affairs sent a written communication relating to the above-captioned proceeding to Chairman Reed E. Hundt, Commissioners Rachelle B. Chong and Susan Ness, each member of the Federal-State Joint Board, and Regina M. Keeney, Chief of the Common Carrier Bureau. A copy of that written communications is attached hereto.

This notice of ex parte communications is filed in accordance with the Commission's rules of practice and procedure.

DATED: April 9, 1997

Respectfully submitted,



VIRGINIA J. TAYLOR  
Staff Counsel



RICHARD A. ELBRECHT  
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April 9, 1997

  
**RECEIVED**  
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The Honorable Reed E. Hundt  
Chairman  
Federal Communications Commission  
1919 M Street, N.W., Room 814  
Washington, D.C. 20554

The Honorable Rachelle B. Chong  
Commissioner  
Federal Communications Commission  
1919 M Street, N.W., Room 844  
Washington, D.C. 20554

The Honorable Susan Ness  
Commissioner  
Federal Communications Commission  
1919 M Street, N.W., Room 832  
Washington, D.C. 20554

The Honorable Kenneth McClure  
Commissioner  
Missouri Public Service Commission  
301 W. High Street, Suite 530  
Jefferson City, MO 65101

The Honorable Julia Johnson  
Commissioner  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Gerald Gunter Building  
Tallahassee, FL 32399-0850

The Honorable Sharon L. Nelson  
Chairman  
Washington Utilities and  
Transportation Commission  
Post Office Box 47250  
Olympia, WA 98504-7250

The Honorable Laska Schoenfelder  
Commissioner  
South Dakota Public Utilities Commission  
State Capitol, 500 E. Capitol Street  
Pierre, SD 57501-5070

Martha S. Hogerty  
Public Counsel for the  
State of Missouri  
Post Office Box 7800  
Jefferson City, MO 65102

Regina M. Keeney, Chief  
Common Carrier Bureau  
Federal Communications Commission  
2100 M Street, N.W.  
Washington, D.C. 20554

Gentlepersons:

The California Department of Consumer Affairs ("DCA") commends you for your effort to implement the federal Telecommunications Act of 1996 ("TCA") in ways that are economically sound, forward-looking, and public-spirited. As the Information Age unfolds, your resolution of the issues raised by the TCA and the new technologies will become increasingly important to everyone.

The purpose of this letter and the enclosed white paper is to emphasize DCA's concern about the Joint Board's recommendation that the Commission fund a federal high-cost area subsidy through a charge on the net income of providers (a "net trans account") instead of an all end user surcharge ("AEUS").

The DCA, which represents consumers of all income levels, is participating in proceedings of the California Public Utilities Commission ("CPUC") to open the local exchange market to competition, and is keenly interested in exploring how to best achieve the goals of universal service and fund any needed subsidies. From both individual consumer and societal standpoints, DCA believes that the explicit, disclosed, customer surcharge is the preferred option for any universal service subsidy program. The lack of definition of what constitutes universal service, the potential size of the subsidy, its potential for deterring innovation, the potential for hurting consumers who are sought to be helped, the phenomenally rapid changes in the market, the complexity of the technical, economic and legal issues, and the concept of openness of government, combine to decide the issue.

If a net trans account were used, the effect would be to hide the funding from the public. Making coerced subsidies explicit helps achieve a subsidy process that is efficient and democratic. An AEUS promotes openness and candor in regulation and the market. It identifies the amount of the subsidy, which customers pay it, and which customers receive it. It helps to "keep things in the open" and provide the best opportunity for correction where needed. Universal service subsidies, by their very nature, disadvantage some groups of customers or services in order to benefit other groups of customers or services. All groups have an interest in knowing in what respects they are benefitted or burdened, so that they can voice their concerns if they disagree with the decisions that the government is making on their behalf. The AEUS is also competitively neutral. It assures that the subsidy contribution is uniform across carriers and across services. Retail customers cannot affect their contribution by changing carriers or the mix of services purchased. Thus, an AEUS minimizes the effect of the contribution on the customer's purchase decision. Like a sales tax, an AEUS provides reasonable assurance that the burden of a government-mandated subsidy program is borne by and known to all customers -- residential and business, large and small.

There is special reason to provide a mechanism of this kind for funding universal service subsidies. The telecommunications process and its cost accounting are complicated and not thoroughly understood even by experts. The potential dollar volume of the universal service subsidy is enormous. A poorly-crafted subsidy process will impair the efficiency of the telecommunications process by imposing costs for which there are no commensurate benefits. The interests of, and equities among, different classes of customers are difficult to define. The concept of universal service (even in a static market) is ill-defined. The goals of universal service are changing as technology evolves. Each of these factors invites the most careful policymaking, auditing, feedback, and improvement processes. Their combined presence makes the presence of a workable auditing, feedback, and improvement process essential.

Economic factors also point to an AEUS as the preferred option. As viewed by Bruce Egan in Information Superhighways Revisited: The Economics of Multimedia, "[d]irect subsidies, especially of the current untargeted variety, are ... not socially efficient. The current flow of toll-to-local, urban-to-rural and large telco to smaller telco subsidies, is generally inefficient because it is not based on need ...."<sup>1</sup> Egan notes that "the advent of competition in local telecommunications markets makes it imperative to conduct a more formal economic analysis to measure the social costs and benefits of universal service policies ...." He argues that "universal service funding mechanisms need to be

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<sup>1</sup> Egan, Bruce L., Information Superhighways Revisited: The Economics of Multimedia (Boston: Artech House, 1996), p. 307.

designed and implemented in a manner that is viable in a competitive environment and that provides the least distortion of the benefits of competitive markets."<sup>2</sup>

Overcharging one customer group or service in order to benefit another customer group or service distorts market signals and thereby misdirects research, product development and marketing, resulting in inefficient markets, in the unavailability of services that might otherwise be provided, and, overall, in the industry's provision of relatively less value to all customers and to society. In an industry where continuing advancements are important to both the economy and individual customers of all income levels, a surcharge is essentially a tax on an important and presumably favored activity. Like all taxes, it deters rather than spurs that activity. Although some level of subsidy to support universal service goals will promote the overall efficiency of the public network, a subsidy that is excessive will be counterproductive. An AEUS will help assure that the subsidy does not become excessive.

Since the percentage of the average consumer's monthly bill that is attributable to local voice telephone service is declining, it is important that universal service issues be addressed with competence and precision, so as not to deter deployment of advanced services that consumers may desire, use and be willing to pay for. If the public switched telephone network is to evolve in ways that will accommodate "distant learning" and other broadband applications, and not force consumers to rely on alternative and probably more expensive telecommunications systems to work at home, takes courses, etc., it is necessary to upgrade the public network to permit those applications, and not burden its evolution by programs of cross-subsidy that deter rather than promote development.

Some people believe that an AEUS is not a politically palatable funding mechanism — that it is better not to inform consumers about what is being done for consumers. That is ironic. If the present system of regulation-mandated cross subsidies is unsound, and if this results from fear that consumers will be irrational in evaluating the behavior of legislators and regulators,<sup>3</sup> the best antidote is to educate consumers, not keep them in the dark. The AEUS will help educate consumers (both those who fund and those who receive subsidies) by making the practical impacts on them explicit.

Now may be the only time that a competently-designed funding process can be put in place. Once the state and federal universal service systems are implemented, it will be as difficult to modify them as it is to modify other major social programs. At this point in the evolution of telecommunications, the U.S. is fashioning a process that could prove to be as large and inappropriate (and perhaps also counterproductive) as the tax subsidy to housing (a \$85 billion program that mainly benefits the most affluent), support to agriculture that goes mainly to large farming organizations, or a deposit insurance program that invites large taxpayer bailouts.

The enclosure discusses the economic, policy, and legal implications of the two methods of financing universal service. It also provides a legal basis for concluding that Section 254(d) of the TCA does not preclude the use of an AEUS, and addresses other arguments made against an AEUS.

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<sup>2</sup> Id., at pp. 228, 231.

<sup>3</sup> This is the view advanced in Kaserman, David L. and John W. Mayo, "Cross-Subsidies in Telecommunications: Roadblocks on the Road to More Intelligent Telephone Pricing," 11 Yale Journal on Regulation (Winter 1994), 119 at 142-146.

Reed E. Hundt  
April 9, 1997  
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We hope that this letter and the enclosed paper will provide a basis on which the Commission can adopt an AEUS funding mechanism for federal universal service programs, as the CPUC has done in California.

Thank you for your attention and consideration.

Sincerely,



VIRGINIA J. TAYLOR  
Staff Counsel



RICHARD A. ELBRECHT  
Supervising Attorney

Enclosure

cc: Peter Arth, Jr.  
Lionel B. Wilson  
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Gretchen Dumas

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